

John Hancock Financial Services, Inc.

John Hancock Place
Post Office Box 111
Boston, Massachusetts 02117



(617)572-0600
Fax: (617) 572-5170
EMail: tmoloney@jhancock.com

Thomas E. Moloney
Senior Executive Vice President
and Chief Financial Officer

September 18, 2003

Via email and facsimile

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Dear Mr. Smith:

I am writing on behalf of John Hancock Financial Services and its subsidiaries in connection with FASB Interpretation 46, *Consolidation of Variable Interest Entities* (FIN 46), and in specific response to the proposed FASB Staff Position FIN 46-b which would defer the effective date of FIN 46 for certain variable interest entities ("VIEs") while the Board considers a modification to paragraph 8(c) which requires that fees to decision makers be included in a VIE's expected residual returns. John Hancock Financial Services and its subsidiary, Declaration Management & Research, LLC, serve as collateral managers in Collateralized Debt Obligations (CDOs) that are subject to consolidation under FIN 46.

We appreciate the opportunity to comment on the proposed FASB Staff Position. We support the overall objectives behind FIN 46 and agree with the board that more transparent financial report results when the assets and liabilities of a VIE are consolidated with a business enterprise if that enterprise has a controlling financial interest in the VIE. However, we believe that FIN 46 will result in consolidation by collateral managers of CDOs in which the managers have no economic interest other than market bases fees, and that FSP FIN 46-b, as proposed, is so limiting that it is of little practical value to such collateral managers. In addition we believe that, in certain circumstances, when a VIE is consolidated due to the application of FIN 46, losses that economically belong to the holders of the debt issued by the CDO will be recorded on the books of the collateral manager and will reverse in future periods as the CDO terminates and the debt holders are paid less than par at maturity. We believe that this result was unintended and could produce misleading financial statements, which would be very misleading and damaging to investors and customers.

Accordingly, we have several comments/concerns related to this topic. The first set of comments involves the definition of which fees paid to the decision makers are to be considered in identifying the primary beneficiary and how they are treated in that determination. The second set of comments concerns the recognition of VIE earnings on the consolidator's financial statements despite the fact that the consolidator has no economic interest other than market based fees in the results of the VIE.

Fees with no Variability

The proposed FSP FIN46-b would defer the effective date for applying Fin 46 "...for a decision maker that receives fees paid by a variable interest entity if the fee has no variability and the decision maker has no exposure to the expected losses of the entity and no right to the expected residual returns of the entity." The concept of "no variability" needs clarification and expansion, particularly with respect to collateral managers. A literal interpretation of "no variability" would indicate that a non-variable fee must be specified as a fixed dollar amount, payable without regard to the effects of market or operational performance on portfolio values or results of the VIE. It also indicates that there can be no risk of not collecting the fee due to early termination of a contract, credit default of the VIE, or other reasons. We are unaware of any situations involving CDOs where investors and collateral managers have agreed to such a fixed dollar management fee, and suspect strongly that none exists. Thus, we believe that, as written, a literal read of FSP FIN 46-b would have the practical effect of not deferring FIN 46's application for CDO collateral managers who are preparing to consolidate managed CDOs because of fees earned from them, and thus would not provide the time required by the Board for consideration of a modification to paragraph 8(c) as it relates to CDOs.

The typical collateral manager fee structure calls for a senior fee that is paid ahead of any other CDO obligation and a subordinated fee that is paid after the debt obligations for the period have been satisfied but before the equity tranche receives any returns. The purpose of the split fee structure is to motivate the collateral manager. Debt investors take comfort in the fact that a portion of the collateral manager's fees are paid after their debt obligations are satisfied. The split fee structure is seen in most CDOs and is considered a market norm. In addition, some manager fees also include performance-based elements which increase fees to the collateral managers if hurdle rate IRRs to the equity investors are achieved. We believe such fees are not part of the manager's core, market-based compensation but instead are a form of equity participation. At a minimum we recommend that the deferral criterion included in FSP FIN 46-b be focused on market based fees being provided for services provided rather than an unrealistic "no variability" structure. Such a deferral would provide the Board time for consideration of a modification to paragraph 8(c).

In connection with the deferral limitation related to other exposures and/or rights, we believe that the question as to whether or not the decision maker may also have another exposure to the expected losses and/or right to expected residual returns should not have a bearing on the decision to defer. The ultimate decision of the FASB as to the treatment of fees may change the consolidation treatment of the VIE by reducing the combination of the two elements, the fees and the other exposure/rights, to a less than 50% position. This could cause more volatility in the financial statements if an enterprise were to consolidate a VIE under its current understanding of FIN 46 but would need to then de-consolidate the VIE based on the Board's final decision. Thus we recommend that the effective date of FIN 46 should be deferred for VIEs if the fee is a market based fee for the services being provided and the decision maker has exposure to less than fifty percent of the expected losses and has rights to less than fifty percent of the expected residual returns of the VIE without giving effect to such market-based fees.

Recognition of Losses

On the second subject and as noted in my previous letter dated August 12, 2003 (a copy of which is attached), we have serious concerns regarding unintended and damaging consequences related to the application of FIN 46 to CDOs where John Hancock does not have an obligation to finance potential losses of third party investors in the CDO but is merely the collateral manager of the assets of the CDO or has a minority interest in the CDO. We believe that the consolidation of income and losses of these CDOs onto John Hancock's financial statements will significantly misrepresent the true operating results and financial position of our company to our customers, creditors, our shareholders and the larger investment community. This would appear contradictory to the intent of ARB 51 which indicates consolidated financial statements should report what is relevant to creditors and shareholders. ARB 51 further indicates that the consolidating entity should bear losses once the minority interest is reduced by losses to a zero balance because the minority interest has no further obligation to support continuing losses. This is not the fact pattern of typical CDOs. Investors in non-recourse debt of a CDO bear all of the responsibility to support losses on non-recourse CDO assets supporting this non-recourse debt. John Hancock and our subsidiary, Declaration Management, serve as collateral managers for \$2.9 billion of CDOs which have been classified as VIEs under FIN 46 and are subject to consolidation reporting for our third quarter 2003 financial statements. Due to recent market performance, these CDOs have accumulated losses in excess of the total equity

invested. These losses will either reverse due to market action on the CDO portfolio, or be borne by the owners of the CDO debt at its maturity.

Recording these losses while consolidating a CDO could result in another unintended consequence in that these losses could render certain consolidators technically insolvent, thus disqualifying them as qualified pension asset managers (QPAMs) under ERISA. This could have disastrous consequences for these CDO managers for no apparent economic reason.

Since our corporate shareholders are not exposed to the economic losses associated with these CDOs, beyond the extent of our actual investment in the CDOs, if any, we do not believe this approach improves the quality of financial reporting or leads to clarity and accuracy in reporting fairly our company's financial position. Rather we consider this outcome as damaging in that, by recording losses (or possibly gains) that are certain to reverse and have no chance of ever being realized by our shareholders, our company would be misrepresenting results of its operations and financial position.

Suggestion for reporting of non-economic losses consolidated under FIN 46:

Losses of a consolidated VIE that exceed the consolidator's investment should be recorded as a contra-liability reflecting third party interests in the VIE's results, thus reflecting the true economic impact of the consolidation. This would avoid the inaccurate portrayal of the consolidator's financial position referenced above and would avoid the misleading volatility in the consolidator's income statements. In any case, we suggest that the FASB consider deferring the application of FIN 46 as it relates to any VIE for which there are losses which exceed the economic obligation of the consolidator to absorb until the FASB can consider the matter.

Conclusion

We recognize and appreciate, as a lender of material sums to many borrowers, that the FASB has an important mandate to set and maintain high quality reporting standards that will facilitate transparency of financial information for the investing public. We believe strongly that this objective will be frustrated, and not achieved, through the application of FIN 46 in its present form as it relates to CDOs. Additionally, the consolidation of operating gains or losses onto our income statement where there is no legal obligation or intent to fund those losses threatens to distort the reported operating results of John Hancock and thus is inconsistent with FASB's larger goals in this effort.

We appreciate your thoughtful consideration of our comments and would be pleased to provide any additional information that would be helpful in your review of this issue.

Sincerely,

Thomas Moloney

Senior Executive Vice President
And Chief Financial Officer